

Not Realizing the True Value of “Stuff”

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This is Part 6 in a Series of the Top 10 Mistakes Made When Planning for Art and Other Collectibles: A Guide for Professionals and Their Clients.

For federal estate and gift tax purposes, transfers are valued at the “fair market value” of the asset on the date of transfer. One of the more common estate tax audit issues is the failure to properly report the value of items of tangible personal property on a decedent’s Form 706. Similarly, failing to properly account for the value of tangible personal property transferred by inter vivos gift may result in the audit of a client’s Form 709. Despite their upfront cost, in order to identify the true value of art and collectible assets, clients should obtain professional periodic appraisals. Appraisals serve many functions, including estate and gift tax reporting, such as establishing value for insurance purposes, establishing bidding parameters for assets at auction, obtaining loans with tangible personal property serving as collateral, and planning for future gifts.

For tax purposes, fair market value is defined as “the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the relevant facts.” Although the most persuasive indication of fair market value is an actual contemporaneous sale of the property in question, in the absence of such a sale, an appraisal is typically required to establish the taxable value of the asset subject to transfer. Under current regulations, a reported gift of tangible personal property that exceeds \$5000 in value must be substantiated by a qualified appraisal conducted by a qualified appraiser.

The Pension Protection Act of 2006 (the “Pension Act”) established new requirements for what it means to have a “qualified appraisal” for tax reporting purposes. A qualified appraisal must contain a declaration that the appraiser (i) understands that a substantial or gross valuation misstatement resulting from an appraisal of the value of the property that the appraiser knows, or reasonably should have known, would be used in connection with a return or claim for refund, may subject the appraiser to a civil penalty, and (ii) understands that an intentionally false or fraudulent overstatement of the value of the appraised property may subject the appraiser to civil penalty for aiding and abetting an understatement of tax liability.

A qualified appraisal of tangible personal property must contain the following:

- a detailed description of the property;
- the physical condition of the property;
- the date or expected date of the contribution;
- the terms of any agreement or understanding entered into or expected to be , entered into by or on behalf of the client that relates to the use, sale or other disposition of the property, including any restrictions on the use or disposition or reservations of rights conferred on anyone other than the donee and any earmarks for particular use;
- the name, address and taxpayer id number of the appraiser;
- a detailed description of the appraiser’s educational background and qualifications;
- the date on which the property was valued;
- the appraised fair market value of the property;
- the method of valuation used to determine the fair market value;
- the specific basis for the valuation; and
- a description of the fee arrangement between the client and the appraiser.

A qualified appraisal is prepared by a qualified appraiser defined as an individual who:

- has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in the regulations;
- regularly performs appraisals for pay; and

- meets other requirements that the IRS has prescribed in the regulations.

An individual cannot be a qualified appraiser with respect to any specific appraisal unless she:

- demonstrates verifiable and passing professional or college level education and experience or earned a recognized appraiser designation from a generally recognized professional trade or appraiser organization or as part of an employee apprenticeship program or educational program; and
- the education and experience is in valuing the property type being appraised.

In addition, the appraiser must make the following declaration:

"I understand that my appraisal will be used in connection with a return or claim for a refund. I also understand that, if there is a substantial or gross valuation misstatement of the value of the property claimed on the return or claim for refund that is based on my appraisal, I may be subject to a penalty under section 6695A of the Internal Revenue Code, as well as other applicable penalties. I affirm that I have not been at any time in the three-year period ending on the date of the appraisal barred from presenting evidence or testimony before the Department of the Treasury or the Internal Revenue Service pursuant to 31 U.S.C. 330(c)."

If the appraisal or the appraiser does not meet all of the above requirements, the resulting valuation report will not be considered as any evidence of value, and the IRS will conduct its own appraisal to determine the fair market value of the asset subject to transfer.

In certain instances, providing the IRS with an appraisal that adheres to all of the requirements of the Pension Act may not help with avoiding an estate or gift tax audit, but provides a powerful bargaining tool. For example, regardless of the asset composition of the remainder of the estate, if a decedent dies owning artwork that has a claimed value of \$50,000 or more, the appraisal will be subjected to consideration by the IRS Art Advisory Panel, comprised of a body of art industry experts who review and evaluate the acceptability of artwork appraisals submitted by taxpayers in support of claimed fair market value. When a qualified appraisal is submitted, you and your client may find that the IRS is more willing to compromise on valuation issues.